The Honorable Karen A. Overstreet
Chapter: 11
Hearing Date: January 10, 2014
Hearing Time: 10:30 a.m.
Response Date: January 8, 2014

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON AT SEATTLE

In Re:	)	Chapter: 11
	)	
CLI HOLDINGS, INC. dba ALYDIAN,	)	Case No. 13-19746-KAO
	)	
Debtor.	)	SUPPLEMENTAL DECLARATION OF PETER VESSENES
	)	

I, Peter Vessenes, Managing Director of the debtor, CLI Holdings, Inc. (dba "Alydian") declare as follows.

1. I believe that an early sale of the Alydian mining systems will benefit the estate. Currently, Alydian pays engineers and managers and hosting and other various operating expenses to continue managing its mining systems. The mining systems generate about 60 Bitcoins per day, but that amount is decreasing rapidly. Mining systems vary in a number of ways, but they are largely denominated in "terahashes", or trillions of "hashes" performed per second. A "hash" is a unit of work that Bitcoin mining systems do. Due to cryptographic innovations published in the Bitcoin paper, it is relatively easy to assess how many hashes a mining system has accomplished without duplicating the effort. This is known as "proof of work."

2. By consensus, the Bitcoin network aims to pay out 25 Bitcoins every ten minutes. It accomplishes this by setting a "difficulty" — a required amount of work proof before the 25

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Bitcoins will be paid out. Every 2016 payouts, the network determines if it has taken more than ten minutes on average, or less than ten minutes on average to accomplish the work. If it has taken less than ten minutes on average, say nine minutes, then the difficulty for the next 2016 payouts (contained in Bitcoin "blocks") would be increased by 11.1% over the difficulty of the prior round.

3. The Bitcoin network's difficulty at launch in 2009 was "1", corresponding to about 4.3 billion hashes needed per block payout. The current difficulty is in excess of 1.4 billion, corresponding to over 6 quintillion hashes needed.

4. As I have explained to the court in previous declarations and testimony, hashing work is akin to flipping coins, and so has an element of luck in it. In essence, one must flip coins until, randomly, one has flipped 42 or so tails in a row. It is possible but unlikely to flip 42 tails in a row at a first try; on average it will take many, many tries to do so.

5. A curious outcome of the payout scheme in Bitcoin is that all miners must share results of their work; the court may consider the following hypothetical about the first two Bitcoin miners who are flipping coins.

6. On the first day, a single Bitcoin miner begins flipping coins, by hand. She videotapes her coin flipping so that she can prove the flip reporting is accurate. She will not need to deliver all her videotape, only a video of the 'winning' flips. The miner can flip coins at a rate that yields five tails in a row every ten minutes. For the next two weeks, the miner flips, and on average she receives 25 Bitcoins every ten minutes for the two weeks (2016 blocks at 10 minutes per block is two weeks of time.

7. At the end of the two weeks, the Bitcoin network assesses the rate of mining and determines that there need be no change in difficulty.

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8. At the beginning of the third week, a second miner joins. He can also flip coins at a rate of five tails in a row every ten minutes. The Bitcoin network pays out for proof of work done, so on average, each of the miners receives 25 coins every 10 minutes. After only one week, 2016 block payouts have been issued, and the network assesses the rate of mining. In this case, it finds that blocks were, on average, issued every five minutes, and so it doubles the difficulty. It will now take six tails in a row to earn a block reward.

9. For weeks four and five, each miner earns 25 Bitcoins every 20 minutes, or half the previous reward they earned. This is the sharing mechanism described above. On week six, a new miner joins. She has designed a coin flipper that can flip six tails in a row every one minute. For a brief period, she earns 25 Bitcoins every minute. The others continue to earn 25 every 10 minutes between them, or 2.5 per minute. At the end of the next 2016 blocks (in approximately 33 hours) the Bitcoin network increases the difficulty to 22. From then on until a new miner joins, or a technology enhancement is created, the new miner will earn 90% of all Bitcoins per day, (25 coins per 11 minutes) and the others will earn 10%. his simple story is played out at very high speed in the Bitcoin mining marketplace as a whole.

10. Attached as Exhibit "A" is a graph of Bitcoin mining difficulty over the last year. (January 8, 2013 difficulty was 3.25 million.) Note the incredible growth rate, in excess of 43,000% annual growth. When there is 43,000% growth in mining proof of work, there is a corresponding decrease in earnings, just as the coin flipping miners saw worse returns when others entered the market. Alydian's 185 terahashes per second would have earned approximately 1,500 Bitcoins per day in July 2013 if they had been deployed, but today they only earn 60 or so Bitcoins. That number will keep shrinking. This massive force outside our control, the speed of the bitcoin miners, has rendered all of Alydian's customer contracts

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impracticable — if other mining competitors had been three months later to market, Alydian could have delivered on all or nearly all of its customer contracts. As it is, there is no way for Alydian to generate enough coins to satisfy even a single larger customer contract, much less the entire set.

11. This possibility was considered in all of the mining contracts Alydian executed; the customers agreed to take all risks of forces outside Alydian's control rendering the contract impracticable.

12. Note that since the agreement was executed with Dalsa Barbour, LLC, Alydian's ability to generate coins has declined by over 90% due to other Bitcoin mining ventures outside of its control. In order to assess the likely future earnings of Bitcoin mining systems, one must forecast the future mining capacity that others will bring to bear. Alydian (and its funders, partners, creditors and customers) have consistently underestimated the growth of this capacity. As of July, 2013 Alydian's estimates were that there would be roughly 1,000 to 1,500 terahashes mining by December, 2013. Customers like Dalsa Barbour suggested publicly and to Alydian that it would be at or below 2,000 terahashes. The most conservative investor we spoke to estimated 4,000 terahashes. Instead, there were over 10,000 terahashes mining by December 31, 2013 and many more will be coming online in the next few months.

13. Forward pricing for Bitcoin mining is fairly easy to determine; retail providers publish prices and estimated delivery dates online. The two most successful seem to be KnC Miner and Cointerra. Currently, Cointerra is selling hashing systems for April delivery at $3,000 per terahash. KnC Miner recently sold a large batch of miners for "Q1/Q2" delivery at $3,300 per terahash. It claims a slight premium in the retail market because they have a proven track record of delivering working mining systems. Cointerra's first mining systems have not yet

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shipped. Spot markets for mining delivery exist. The largest is cex.io, a UK marketplace. These markets, while illiquid, can be used to estimate the current market price of mining systems. As of December 22, 2013, the price was approximately $65,000 per terahash. As of January 4, the price per terahash was approximately $35,000. These terahashes are different from purchasing mining rigs -- they are available immediately and carry no future costs (the provider selling the hashes covers future operating costs). They also carry some additional risk -- there are no guarantees the miner will keep providing the hashes into the future.

14. The price difference between “free to operate hashes right now" and “future hashes in April or May 2014” allows us to assess market sentiment about how many more mining systems are being added to the marketplace. In the last few weeks, that sentiment has changed radically, as witnessed by the huge price drop for hashes in the spot market.

15. The potential for a massive price drop is one of the concerns that led Alydian to ask for an expedited sale. We do not know what will happen to the spot price between now and the final sale, but we can see with some certainty that the price of mining systems is very likely to be closer to $3,000 per terahash in April 2014 than it is to be close to $35,000.

16. Because Alydian's core team has stated they likely do not wish to remain on after January 31, 2014, and because of the near certainty that hashing prices will continue to decrease over the next few months, I believe it is in the best interest of the estate to sell the systems quickly. I believe that current market sentiment as to the value of Bitcoin mining systems is still too optimistic, and therefore that there may be significant future price drops.

17. A sale will significantly lower Alydian's monthly expenses, and, if I am correct that market sentiment is overly optimistic, would perhaps allow us to generate even more Bitcoins in a sale than could be mined by the systems in the future. Of course, market price

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forecasts are speculative, and we do not know the future value of mining systems, or the future Bitcoin or mining system price. However, we do know that Alydian's hosting costs will continue, and that without a core team to manage the mining systems, there will be no mining at all. If it could have sold the Alydian systems on December 22, 2013 at the spot market price, the assets of the estate would have generated in excess of $11mm. As of today, the spot market price would yield only $6.2mm. There are a number of reasons to believe that Alydian will not receive full spot market value for these systems, including the difficulty of managing them, as compared to the ease of simply using a trading platform with no further fees, however I believe waiting even a few weeks carries the strong risk of seeing further market moves that will lower the value of Alydian's mining systems.

18. Attached hereto and marked Exhibit B is a graph demonstrating the history of bitcoin mining rig prices since December 8, 2013.

19. For these reasons, I believe it is in the best interests of the estate to sell these mining systems as quickly as possible.

I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

Signed in Seattle Washington this 6th day of January 2014.

/s/Peter Vessenes
Peter J. Vessenes

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